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IN THE

Supreme Court of the United States

OCTOBER TERM 1978

No. 79-511

ANNE MOEN BULLITT BIDDLE BREWSTER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The petitioner, Anne Moen Bullitt Biddle Brewster, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit entered in this case.

OPINIONS BELOW

The opinion of the Court of Appeals, not yet reported, appears in Appendix A hereto. The opinion of the United States Tax Court, 67 T.C. 352,* appears in Appendix B hereto.

**Anne Moen Buttill Brewster*, 67 T.C. 352 (1976), *aff'd per curiam*, _____F.2d_____ (79-1 USTC ¶ 9398) (D.C. Cir. 1979), *rehearing denied*, 6/29/79 (hereinafter referred to as *Brewster II*).

JURISDICTION

The judgment of the Court of Appeals for the District of Columbia Circuit was entered on June 1, 1979. See, Appendix A hereto. Petitioner's timely petition for rehearing with a suggestion for rehearing en banc was denied on June ~~28~~ 25, 1979. Appendix C hereto is the order of denial. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1) as provided in Section 7482(a) of the Internal Revenue Code of 1954 (26 U.S.C. §7482(a)).

QUESTIONS PRESENTED

1. Whether the court below properly withheld from the petitioner her opportunity to be heard by invoking the discretionary rule of *stare decisis* where the issue before that court in this case differed from the issue presented to it in previous litigation.

2. Whether the courts below improperly invoked discretionary rules of review in the changed circumstances of this case so as effectively to render review —proof both as to this taxpayer and all other U.S. citizen taxpayers resident abroad the result reached in the earlier litigation.

3. Whether 26 U.S.C. §911, which provides that "earned income means * * * a reasonable allowance as compensation for the [taxpayer's] personal services * * * not in excess of * * * 30 percent of * * * the net profits" of the taxpayer's business, can be construed to mean that earned income exists when that business has a net loss and can then be applied to the clear detriment of a taxpayer resident abroad when Congress' plain intent in enacting that provision was to benefit U.S. taxpayers resident abroad.

STATUTES INVOLVED

This case concerns the interpretation and application of section 911 of the Internal Revenue Code of 1954 (the "Code") [1] (26 U.S.C. §911), pertinent portions of which are set forth in Appendix D hereto.

STATEMENT OF THE CASE

This case involves the correctness of the Commissioner's determination of deficiencies totalling $186,893.44 in the taxpayer's Federal income tax for the years 1962 through 1965 and 1967 through 1969 inclusive.

During those years the taxpayer was a U.S. citizen residing in Ireland where she engaged in a farming business as a sole proprietor. Both her personal services and her capital were material income producing factors in that business. In each of the years in question the taxpayer's gross business income was exceeded by her business expenses, hence she suffered a net business loss.

Section 911(a) excludes "earned income" from gross income for qualifying U.S. citizens resident abroad. Section 911(b) defines earned income of a service-capital business as a reasonable allowance for the proprietor's services, limited to 30 percent of the net profit of the business. Section 911(a) goes on to provide that deductions attributable to excluded earned income must be disallowed.

The Commissioner held that the taxpayer had excludable earned income from her business notwith-

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[1] References hereinafter to sections are to sections of the Internal Revenue Code of 1954 unless otherwise indicated.

standing its net loss, then invoked the deduction disallowance provision in a manner which resulted in the disallowance of deductions greatly in excess of the excluded earned income. The deficiencies in question resulted.

In the courts below the taxpayer argued that in a loss business earned income could not arise under section 911, if only because under the specific statutory limitation keyed to net profit, when there is not net profit, 30 percent of zero is zero, and thus without earned income the deduction disallowance provision could not operate.

The question whether section 911 can apply at all to a foreign service-capital loss business was litigated as a question of first impression by this taxpayer for several earlier taxable years. A divided Tax Court held that it could. The court of appeals affirmed.[2]

The facts in *Brewster I* were fully stipulated. That stipulation was based on the agreement of the taxpayer and of the Commissioner that if and only if section 911 was held to apply to a foreign service-capital loss business then a few, but not all, of the 28 expense items of the taxpayer's business would be treated as attributable to earned income and therefore subject to the section 911(a) deduction disallowance provision. Against the backdrop of that stipulation, *Brewster I* resulted in modest deficiencies for the taxpayer in several of those years[3] and a refund of tax for one year.

[2] *Anne Moen Bullitt Brewster*, 55 T.C. 251 (1970) *aff'd per curiam*, 473 F.2d 160 (D.C. Cir. 1972). The prior litigation will hereinafter be referred to as *Brewster I*, and, as noted above, the present case will be referred to as *Brewster II*.

[3] See 55 T.C. at 255.

In *Brewster II*, the Commissioner adopted a new and different approach. Using *Brewster I* as a springboard, in the present case the Commissioner took the position that all of the disbursements from the business, but only a small portion of its gross receipts should be subject to his calculation to arrive at a net deduction disallowance. The result of using that formula, admitted by the Commissioner to be arbitrary[4], necessarily produced a grossly distorted disallowance of business deductions in relation to the deemed earned income excluded from gross income.

Aggrieved by the Commissioner's change of position, in this case the taxpayer asked the Tax Court to reconsider its view of the statute in the light of undisputed evidence presented at trial to the effect that none of the expenses of the taxpayer's business were of a sort which were properly attributable to her personal services.

The Tax Court majority, notwithstanding the Commissioner's changed position as to the construction and application of the statutory provision and the trial testimony, refused to review its original approach to section 911 reasoning that, because the appellate court in *Brewster I* had affirmed its primordial view of Section 911, and because the appeal from its decision in *Brewster II* would lie to the same circuit which had considered the issue previously, it was bound by its own procedure not to do so.[5] However, it did not take that stance as a unified court.

[4] Statements of Commissioner's counsel at trial in colloquy with Judge Goffe. (R. 80-81).

[5] 67 T.C. 357-358 (Appendix pp. 28a-29a); see *ibid.*, 367-368 (dissent) (Appendix pp. 42a-43a); *Jack E. Golsen*, 54 T.C. 742 (1970), aff'd on other grounds 445 F.2d 985 (10th Cir. 1971).

All of the Tax Court judges who were willing to look again at the statutory construction issue on its merits concluded unanimously that *Brewster I* was wrong. One judge agreed with the dissenters' view, but felt that she was barred from considering the questions because of the internal procedural rule. Perhaps most noteworthy among the dissenters in *Brewster II* was one judge who had aligned himself with the majority in *Brewster I* in construing the statute against the taxpayer, but was persuaded by the taxpayer's position in this case.

The appellate court upheld the trial court by invoking *stare decisis* and so also declined to review its original position as to the construction of the statute.

As a result, in this case, the taxpayer was denied judicial consideration of the basic legal issue, notwithstanding the Commissioner's changed position.

In addition, the decision below is patently wrong because it works an absurd perversion of Congress' intent by using a statute plainly designed to benefit U.S. taxpayers abroad to their immediate and significant detriment. The result below is in apparent conflict with an opinion of the Court of Claims, and presents an issue of importance to the even-handed administration of the revenue to this taxpayer and to the many others who are similarly situated.

REASONS FOR GRANTING THE WRIT

I. THE DECISIONS BELOW DEPART FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS SINCE THEY EFFECTIVELY PRECLUDE U.S. TAXPAYERS WHO RESIDE ABROAD FROM RECEIVING THE SAME OPPORTUNITY TO BE HEARD ON A GIVEN ISSUE THAT IS ACCORDED THEIR COUNTERPARTS RESIDENT IN THIS COUNTRY.

The courts below denied the petitioner her opportunity to be heard. By doing so, they established a precedent which can preclude this taxpayer and other U.S. taxpayers who live abroad from litigating any given tax issue to the extent that their peers in this country could. That result is so plain a departure from "the accepted and usual course of judicial proceedings" addressed in Rule 19(b) of this Court, that review is warranted. The result of that review should be a remand with directions to give the taxpayer her opportunity to be heard. In the alternative, the Court should decide the case on its merits.

As a general rule, an issue which concerns the construction and application of a federal tax statute can receive diverse judicial consideration before it is finally and fairly laid to rest either in favor of the taxpayer[6] or of the government.[7] During that process individual taxpayers may win or lose their particular case, but the issue itself can receive full and fair consideration.

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[6] See, e.g., *Kurzner* v. *United States*, 413 F.2d 97 (5th Cir. 1969) and Rev. Proc. 65-27, 1965-2 C.B. 1017 (four circuits favored taxpayers' position before Commissioner agreed); Rev. Rul. 70-101, 1970-1 C.B. 278 (Commissioner abandoned position only after 14 defeats in different courts); Rev. Rul. 75-561, 1975-2 C.B. 129 (Commissioner abandoned position after losing in 9 separate courts).

[7] *United States* v. *Cannelton Sewer Pipe Company*, 364 U.S. 76, reversing 268 F.2d 334 (1957) (five circuits favored taxpayers' position before a decision by this Court in the government's favor.)

The group of U.S. taxpayers who reside abroad[8] do not have the juridicial luxury of diverse judicial consideration of an issue which their peers in this country enjoy. Instead, they are locked in to consideration of any tax issue particular to them, such as section 911, by only one appellate court.[9] If that appellate court refuses to consider a second issue which is a permutation of a first issue already considered or, indeed, refuses to reconsider the first issue, it can effectively render review-proof its initial decision on any issue and thereby theoretically leave the final resolution of that issue only to this Court.

But, since the roster of federal tax cases taken to be heard by this Court in any term is a bit scant, for all intents and purposes an issue raised for the second time by a U.S. taxpayer abroad is necessarily dead-ended, in contrast to an issue questioned by U.S.-resident taxpayers who have, as a group, the opportunity for multiple appellate judicial attention.

Given that, one would suppose the Tax Court and its appellate court would literally bend over backward to think or rethink their prior decisions on any given issue for a nonresident U.S. taxpayer since it is rudimentary that "[T]he fundamental requisite of due process of law is the opportunity to be heard." *Grannis* v. *Ordean*, 234 U.S. 385, 394 (1914).

This taxpayer was roundly denied that opportunity. Under the approaches of the courts below others similarly situated will also be denied that opportunity, as to this and other issues, if the decision below is allowed to stand.

As a practical matter the taxpayer here is still seeking the first judicial consideration of her main argument, *viz.*, that in the context of this case as newly framed by the Commissioner, a service-capital proprietorship which operates at a loss does not generate compensatory earned income.[10] The Tax Court majority, relying on its procedural *Golsen* rule, refused to consider the question. The appellate court followed suit saying, "the principle of *stare decisis* precludes our consideration of appellant's first argument",[11] notwithstanding its admission that the Commissioner's position on the merits produces "certain incongruities" and "bizarre results."[12]

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[8] There are about 140,000 U.S. individual taxpayers who live abroad and use, or are used by, section 911. See Joint Committee on Taxation, General Explanation of the Foreign Earned Income Act of 1978 (2-23-79) p.1. The statistic is for 1975, the most recent year for which data is available.

[9] As Judge Goffe pointed out in his dissent (67 T.C. at 368; Appendix p. 43a), "a whole class of taxpayers (U.S. citizens residing abroad), are precluded [by the application of the *Golsen* rule] from having us reexamine [a] prior holding *** unless such taxpayers pay the tax and sue the Court of Claims or unless they change their residence to the United States, except to the District of Columbia."

[10] The taxpayer's position was initiated by the Service in 1929 when, as to earned income of a service-capital business it ruled that "a taxpayer gets nothing for his services in a business which results in a loss" (G.C.M. 6563, VIII-2 C.B. 186, 187). That apparently remained the Service's position for about 40 years, until *Brewster I* arose with its new position.

[11] Slip. op. 4 (Appendix p. 4a).

[12] Slip op. 8, 10 (Appendix pp. 8a, 10a). The unfairness here is further exacerbated by the Commissioner's admission at trial that his formula for the application of section 911 was "an arbitrary method." (R. 81). Whatever the current general vitality of *Helvering* v. *Taylor*, 293 U.S. 507 (1935), it is at least clear that an admittedly arbitrary approach to the application of the statute by the government in contrast to its approach in *Brewster I*, should have compelled the courts below to rethink the proper construction of the basic statutory provision.

This court has recognized that *stare decisis* is a matter of even-handed judicial policy, not an inexorable rule of law which blinds a court to new ideas and changed circumstances. *Helvering* v. *Hallock*, 309 U.S. 106, 119 (1940). The coupling of the *Golsen* rule in the trial court with *stare decisis* in the appellate court results in a grave injustice to this taxpayer and will be an unconscionable impediment to all other U.S. taxpayers abroad who must necessarily follow in the narrow procedural path thus alloted them, in contrast to their peers resident in this country. This Court, in its role as the steward of judicial administration for inferior courts, must notice and correct the blunder below in the interest of the uniform application of justice.

The absurdly prejudicial treatment accorded to this taxpayer, and to be accorded to others like her, is case in bold relief by the Tax Court's decision in *Max Zager*, 72 T.C.____ (No. 82) (decided September 5, 1979). There, the court did for a resident U.S. taxpayer precisely what it refused to do for this nonresident taxpayer. Faced with the Commissioner's argument that it should review and overrule a prior adverse decision to which he was a party, the court painstakingly reviewed and weighed the intrinsic rationale of its first decision, then considered carefully the new arguments presented by the Commissioner. On balance, it determined that it would stand by its original position and so decided adversely to the Commissioner. In *Zager* the potential appeals in the prior case and in *Zager* itself lay to different circuits. Since the *Zager* circuit had evidently not spoken on the issue, the Tax Court found itself unfettered by a self-imposed procedural restraint to reconsider its prior view, and did so. This taxpayer's case is a much stronger one for full consideration or reconsideration of the issue since, unlike *Zager*, the Commissioner espoused a changed position here and, unlike *Zager*, the issue has no other circuit as a forum. Accordingly, in *Zager*—unlike this case—the litigant challenging the initial decision, to which he had been a party, was indeed given the full "opportunity to be heard" required by *Grannis* v. *Ordean*, *supra*. Unless that opportunity is available, this taxpayer and her peers will be impermissably isolated from the remedies available to most other taxpayers. See, *Laing* v. *United States*, 423 U.S. 161, 176 (1976).

Because this taxpayer has not been heard, the decision below plainly departs from the "accepted and usual course of judicial proceedings" contemplated by Rule 19 of this Court, both as to this taxpayer and as to other U.S. taxpayers resident abroad who may be required to follow in her footsteps. Accordingly, certiorari is warranted with a view to remanding the matter for the full and fair consideration it deserves, or for a decision by this Court on the merits.

II. THE DECISION ON THE MERITS IS WRONG.

The taxpayer does not insist on her opportunity to be heard as a mere academic exercise. There appears to be a good chance that she would prevail on the merits.

Of the Tax Court judges who were willing to consider the basic legal issue in this case, *all* were convinced that *Brewster I* was wrong. In addition, the Tax Court judge who concurred with the majority stated flatly that she thought *Brewster I* was wrong.

(The remainder did not reach the issue because of their view of *Golsen*.)

Apart from that, section 911 has been wrongly applied here. By its terms, section 911 earned income in a service-capital business is limited to a portion of net profits. Accordingly, on the face of the statute, absent a net profit a proprietor can have no earned income.[13]

The language of Section 911, like all other statutory language, is to be given its plain and ordinary meaning. See, *Helvering* v. *Flaccus Leather Co.*, 313 U.S. 247, 249 (1941); *Addison* v. *Cherry Hill Co.*, 322 U.S. 607, 617 (1944); *Old Colony Co.* v. *Commissioner*, 301 U.S. 379, 383 (1937).

If, however, section 911 is unclear or ambiguous then it must be construed and applied in a manner consistent with the legislative policy that was the underpinning for its enactment. *Addison* v. *Cherry Hill Co.*, *supra*. Because of that, if two alternative constructions are otherwise reasonable, the controlling alternative is that which preserves the purpose of the enactment, see, *Sunshine Coal Co.* v. *Adkins*, 310 U.S. 381, 392 (1940), and which produces a common-sense result consistent with the Congressional intent, see *United States* v. *American Trucking Ass'n*, 310 U.S. 534, 543-545 (1940); *Helvering* v. *Wardman*, 68 F.2d 418 (D.C. Cir. 1933); and see 1 Mertens, Law of Federal Income Taxation (1974 rev.) §3.26.

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[13] As indicated above, note 10, the Commissioner early construed the statutory phraseology to mean that a loss service-capital business produces no earned income. G.C.M. 6563, VIII-2 C.B. 186, 187.

The construction of section 911 and its application to this case by the court below produces an absurd result that cannot be consistent with the legislative intent.

The appellate court has recognized that the Congressional intent which underlies section 911 is to provide a benefit to U.S. taxpayers who work abroad. *Commissioner* v. *Wolfe*, 361 F.2d 62, 66 (D.C. Cir. 1966) *cert. denied*, 385 U.S. 838.[14] Congress continues to view section 911 as a provision which is intended to confer a benefit. Thus, for example, recent legislation refers to "an individual * * * entitled to the benefits of section 911".[15] The trial court paid obedient lipservice to that intent in the first sentence of its opinion[16] then proceeded to render an opinion diametrically opposed to that intent. The result, therefore, appears to be that while a limited benefit (a percent of net profits) is given to successful proprietors an unlimited detriment is applied against them when they suffer a loss. It boggles the mind to believe that Congress truly legislated that outcome.

It is plain that had the taxpayer carried on identical farming operations in this country at a loss she would not have had deductions disallowed and thereby incurred the substantial deficiency the courts below have determined. Even if the legislative history is otherwise unclear, it is inconceivable that Congress could have intended section 911 to give rise to such an

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[14] See also, *Anne Moen Bullitt Brewster*, 55 T.C. 251, 255-256 (dissent).

[15] P.L. 95-615, sec. 4(b)(1) (Tax Treatment Extension Act of 1977).

[16] 67 T.C. at 356 (Appendix pp. 26a-27a).

inconsistent and unfair result or to be used as a weapon against a taxpayer.

III. THE DECISION BELOW CONFLICTS WITH A DECISION OF THE COURT OF CLAIMS AS TO THE CONSTRUCTION AND APPLICATION OF SECTION 911 TO A FOREIGN SERVICE-CAPITAL BUSINESS

The court below held that the earned income of a service-capital business was to be determined by reference to the gross income of that business without regard to whether or not the business generated a net profit. It said (slip op. 8, Appendix p. 8a): " 'earned income' in §911 is structured in terms of gross income rather than net profits."

The Court of Claims holds that the section 911 earned income of a partner arises *only* if his business has a net profit. It said: "Section 911 * * * contrary to the Government's contention, is not structured around gross income." *Vogt* v. *United States*, 537 F.2d 405, 409 (C. Cl. 1976). That difference in concept is not mere sophistry; it is of central importance to taxpayers like this one.

According to *Vogt*, the owner of a business does not have earned income (i.e., compensatory remuneration from business profits) for his services unless and until the business has a net profit. That result makes economic sense because, absent a profit, the owner—whether proprietor or partner—must dig into his own pocket to make up the operating loss of his business. Under the *Brewster II* concept, the proprietor thus necessarily gets his compensatory earned income out of his own capital. But a taxpayer's capital is not his

income.[17] *Vogt* properly rejected that view, hence a conflict exists.

It is true that in the *Vogt* and *Brewster II* opinions each court went out of its way to avoid acknowledging a conflict with the other: the *Vogt* opinion says that it is different than *Brewster I*, and the *Brewster II* opinion enthusiastically agrees, pointing to the fact that *Vogt* dealt with a partner and *Brewster II* dealt with a proprietor. In fact, there is no real conceptual difference, and both courts stayed well clear of saying there was a real difference.

In *Vogt*[18] one of the major concerns motivating the court's decision was its perception that the government's "gross income" method of applying the section 911 earned income exclusion resulted in unfair discrimination between salaried employees abroad and individuals conducting their business abroad in partnership form. That discrimination arises because a partnership conducting a business will ordinarily generate a larger proportionate amount of expense in earning income for a partner than will an employee of that business in earning his salary. Since the effect of the government's position in *Vogt* was to disallow a certain amount of the expenses incurred in earning a

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[17] "In order to determine whether there has been gain or loss [from a commercial activity], and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration." *Doyle* v. *Mitchell Brothers*, 247 U.S. 179, 185 (1918) *(dictum)*; see, *Stratton's Independence* v. *Howbert*, 231 U.S. 399, 415 (1914); see also, Magill, Taxable Income 367-73 (Knopf ed. 1945); Surrey, Warren, McDaniel and Holt, Federal Income Taxation (vol. 1) 300-304 (1972).

[18] 537 F.2d at 408-409, note 3.

partner's income that kind of disallowance would obviously fall more heavily on the partner who had greater expenses per dollar of available income, than it would on an employee who received the same compensatory dollar amount.

Exactly the same considerations apply to a sole proprietorship as compared to an employee. Indeed, the *Vogt* court's concern about the discriminatory result of the government's section 911 position should be heightened where a business is conducted as a sole proprietorship. Like a partnership, a sole proprietorship will ordinarily incur greater amounts and a wider variety of expenses in earning income than would an employee who earns income from activities equivalent to those of a proprietor. Here, the court below puts a salaried employee with earned income in a better tax position than a sole proprietor to whom is attributed the very same amount of earned income. The *Vogt* result resolved the problem in favor of equality of treatment: *Brewster II* fosters inequality with no discernable basis in section 911 for doing so.

Shortly before the *Brewster II* opinion was handed down the Court of Claims decided *Cook* v. *United States*, _____ F.2d _____ (decided April 18, 1979, C. Cl. No. 442-75, petition for rehearing pending).[19] *Cook* dealt with a U.S. sole proprietor residing abroad. It adopted the *Brewster* approach, and distinguished *Vogt* holding, in effect, that the taxpayer's earned income derived from his gross income.

[19] The court below did not refer to *Cook* in its *Brewster II* opinion even though *Cook* was decided about six weeks before *Brewster II*. It seems fair to assume that omission was simple oversight.

Cook does not detract from the conflict between *Brewster III* and *Vogt*. In *Cook* the court appears to have suffered from a paucity of assistance by counsel for both parties[20] since it complains that the taxpayer (slip op. 6) "has not shown (or even argued) that the Service has any long-standing administrative policy allowing (sic) individuals to exclude foreign source income from a net figure." In fact, some of the long-standing administrative authorities cited in *Vogt* involved individuals.[21] If nothing else, *Cook* is a prime illustration of the confusion in this area which only this Court can resolve.

This Court has been disposed in recent years to accept cases for consideration where there is only an apparent conflict among intermediate courts.[22] Here, there is not an apparent conflict, there is a real con-

[20] The amount involved in *Cook* ($40) was de minimis and perhaps therefore did not consume the intense attention of counsel or of the court.

[21] See, *Warren R. Miller, Sr.*, 51 T.C. 755 (1959); Form 2555 as issued in years through 1968; *Daniel A. Robida*, 29 TCM 407 (1970) aff'd 460 F.2d 1172 (9th Cir. 1972); Rev. Rul. 55-171, 1955-1 C.B. 80; Rev. Rul. 70-491, 1970-2 C.B. 92; and Rev. Rul. 57-142, 1957-1 C.B. 246, revoked on other grounds in Rev. Rul. 66-326, 1966-2 C.B. 281. All were relied on in *Vogt*, but disregarded in *Cook*.

[22] That has occurred, for example, where a circuit court has declined to follow a Court of Claims decision (*Commissioner* v. *Idaho Power Co.*, 418 U.S. 1, 4 (1974)); where two circuits disagreed on essentially the same issue tried in the Tax Court (*Snow* v. *Commissioner*, 416 U.S. 500, 501 (1974)); where circuits differ on essentially the same issue rising from various district courts (*NLRB* v. *Savir Mfg. Co.*, 414 U.S. 270, 272 (1973)); *United States* v. *Maze*, 414 U.S. 395 397 (1974); *Marshall* v. *United States*, 414 U.S. 417, 418 (1974); and where appellate courts differed in reviewing orders of government agencies (*National Cable Television Ass'n* v. *United States*, 415 U.S. 336, 340 (1974)); *Edelman* v. *Jordan*, 415 U.S. 651, 658 (1974).

flict in an important sense between the court below and the Court of Claims. That conflict should not go unresolved. Moreover, because of the narrow range available for judicial consideration in cases like this, the question here can only be decided in this Court. Certiorari should be granted.

IV. REVIEW OF THIS CASE IS IMPORTANT TO THE EFFECTIVE ADMINISTRATION OF THE INTERNAL REVENUE CODE

According to information given to the taxpayer by the Commissioner under the Freedom of Information Act[23] there appear to be about 100 docketed cases pending decision which involve section 911. While all certainly do not deal with the precise procedural and substantive issues presented here, based on a random sampling by the taxpayer a fair estimate is that roughly half of them have, implicitly or explicitly, questions which concern either the potential denial of review or the proper construction and application of the statutory provision involved here.[24]

It is very difficult for a non-governmental litigant to assert before this Court that his own particular case poses issues of sufficient importance to the administration of the revenue to capture the time and attention of this Court. Indeed, even when the government seeks review the Court may grant it with some hesitation evident in the Court's description of an issue as "seemingly important." *United States* v. *Kahn*, 415 U.S. 143, 150 (1974); and see, *Teleprompter Corp.* v. *United States*, 415 U.S. 394, 399 (1974) (both private litigants sought review).

Here, however, it is fair to say that the denial of appropriate review by both courts below is not of seeming importance, it is indeed important to the fair, proper and effective administration of the Internal Revenue Code for U.S. citizens, like this taxpayer, resident abroad. Certiorari should be granted.

[23] 5 U.S.C. §552.

[24] Section 911 was amended in 1976 (P.L. 94-455, 90 Stat. 1520 (1976)), and in 1978 (P.L. 95-615, 92 Stat. 3097 (1978)). The effect of the amendment is to end the application of the statutory construction issue of section 911 as to this taxpayer after 1978. The issue remains for her taxable years 1970 through 1978. However, that change in statutory coverage does not affect the more basic issue raised in the first point of this petition as to this taxpayer, and more generally for other U.S. individual taxpayers abroad. Accordingly, the statutory change does not undercut the need for certiorari in this case. See *Warden* v. *Marrero*, 417 U.S. 653, 654 (1974).

CONCLUSION

Certiorari should be granted and the case should either be decided by this Court in favor of the taxpayer or remanded with instructions that the basic issue of statutory interpretation and application be addressed, for the first time.

Respectfully submitted,

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September 26, 1979

APPENDICES

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APPENDIX A

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S.App.D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 77-2010

ANNE MOEN BULLITT BIDDLE BREWSTER, APPELLANT

v.

COMMISSIONER OF INTERNAL REVENUE, APPELLEE

Appeal from Decision of the
Tax Court of the United States
(U.S. Tax Court No. 7063-71)

Argued February 23, 1979

Decided June 1, 1979

Judgment entered this date

Michael Mulroney with whom *Thomas E. Jenks* was on the brief, for appellant.

Gilbert S. Rothenberg, Attorney, Department of Justice, with whom *M. Carr Ferguson*, Assistant Attorney General, and *Gary R. Allen*, Attorney, Department of Justice, were on the brief, for appellee.

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

Also *Stuart E. Seigel*, Attorney, Internal Revenue Service, entered an appearance for appellee.

Before MACKINNON and ROBB, *Circuit Judges*, and RICHEY,* *United States District Judge* for the United States District Court for the District of Columbia.

Opinion Per Curiam.

PER CURIAM: A Tax Court decision upheld the Commissioner's determination that there was a deficiency in appellant's returns for the years 1962-65 and 1967-69 inclusive, and she appeals. The Commissioner based his determination upon section 911 of the Internal Revenue Code of 1954, 26 U.S.C. § 911 (1976). Section 911, which only applies to United States citizens who are *bona fide* residents of a foreign country, excludes from a taxpayer's gross income certain amounts of "earned income" attributable to personal services performed abroad. It concomitantly disallows as deductions expenses allocable to or chargeable against this earned income.[1]

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* Sitting by designation pursuant to 28 U.S.C. § 292(a).

[1] § 911. Earned income from sources without the United States

(a) General Rule

The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) Bona fide resident of foreign country

In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during

During the years in issue here, appellant was a citizen of the United States and a *bona fide* resident of Ireland, where she owned and managed a farming business in which her personal services and capital were material income-producing factors. She argues that section 911 does not apply to a service-capital business that operates, as hers does, at a loss. Alternatively, she contends that if section 911 does apply to her business, then the Commissioner unlawfully and arbitrarily computed the amounts of her excluded earned income and correspond-

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such uninterrupted period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

. . . .

An individual shall not be allowed as a deduction from his gross income any deductions (other than those allowed by section 151, relating to personal exemptions), or as a credit against the tax imposed by this chapter any credit for the amount of taxes paid or accrued to a foreign country or possession of the United States, to the extent that such deductions or credit is properly allocable to or chargeable against amounts excluded from gross income under this subsection.

(b) Definition of earned income

For the purposes of this section, the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

26 U.S.C. § 911 (1976).

ingly disallowed expense deductions.[2] We hold that the principle of *stare decisis* precludes our consideration of appellant's first argument. On appellant's second contention we hold that the Tax Court correctly construed section 911's exclusion and disallowance provisions and did not clearly err in upholding the Commissioner's application of those provisions in this case. Hence we affirm.

I

Since 1956, appellant has been the sole proprietor and active manager of a 700 acre farm in County Kildare, Ireland. Although appellant raises cattle and grows some crops on the farm, these activities are incidental to the principal object of the business, the breeding, training, and racing of horses. When she acquired the farm, appellant intended only to engage in the breeding and racing business. Subsequently, poor results with outside trainers induced her to become involved in the training business as well. Appellant believed that coordinated development of breeding and training, a program fully implemented at the outset of the period in issue here, would produce a greater degree of knowledge about an individual horse's capacity, stamina, and temperament.

It is customary in Ireland for proprietors situated as appellant to employ a stud farm manager and a racing

[2] Appellant also urges us to allow her to elect the income-averaging provisions of 26 U.S.C. § 1301. Our review of the record yields no indication that apellant raised this point below. Accordingly, we decline appellant's invitation to probe the availability of section 1301. *Cf.* Doe v. McMillan, 459 F.2d 1304, 1311 n.10 (D.C. Cir. 1972), *rev'd in part on other grounds*, 412 U.S. 306 (1973); Miller v. Avirom, 384 F.2d 319, 321 (D.C. Cir. 1968). We do not intend, however, to attach *res judicata* effects to this issue so as to perclude the Commissioner, in the interests of complete justice, from examining this question, and, if appellant's position is sound, from granting appropriate relief. *Cf.* Glowinski v. Commissioner, 243 F.2d 635 (D.C. Cir. 1957); n.5 *infra*.

trainer to oversee, respectively, the breeding and training operations, as well as a general manager to supervise the entire business. Appellant, however, performs all three of these functions herself, personally supervising all facets of her horse farm. In her capacity as general manager, she works at the farm all day, seven days a week. She is a professionally licensed trainer. She personally directs such things as the breaking of yearlings in preparation for training and the selection of apprentices and jockeys. She regularly checks all the horses on her farm and determines such matters as when corrective shoeing is necessary and when treatment of foals is required. She also does her own secretarial work and directs payments of all expenses.

To assist her on the farm, appellant employs approximately forty-five to fifty persons. Among these are an accountant, who handles all the books and also supervises the cattle-grazing and crop-growing operations; a stud groom, who acts as foreman of the breeding operation and as its manager in appellant's absence; and a head lad, who is the stud groom's counterpart in the training operation. Appellant operates her farm as a proprietorship; she does not pay herself a salary.

On her federal tax returns for the years in question, appellant reported all her gross farm income and deducted all her gross farm expenses. The gross farm income, representing the ordinary income from the conduct of appellant's farm, consisted of income from the sale of cattle and manure, horse boarding fees, and net race winnings. It did not include income appellant realized from the sale of horses, which income appellant separately reported as long-term capital gain. Apellant's gross farm expenses, representing the ordinary expenses associated with the realization of ordinary income, consisted of wages and social insurance for her employees; feed for horses; grass seed for pastures; depreciation

not recaptured from the sale of horses; general supplies; repairs; fertilizers; stud fees and boarding expenses of brood mares at other farms; veterinary and other medical expenses; costs associated with operating machinery; insurance; bank interest and charges; electricity and telephone; rent; local taxes; carriage and freight for transporting horses; motor car expenses; horse-shoeing; costs attributable to training horses at other training farms; straw and peat moss; management fees; saddlery; periodicals dealing with horse breeding, training, and racing; stationery and postage; gratuities to employees; travel and entertainment; subscription and entry fees for registration of horses in the stud book; tools and short-life equipment; advertising; commissions and fees associated with the sale of cattle; legal expenses; rental of special machinery; and fees associated with horse races. Appellant did not include in her gross farm expenses those expenses associated with the sale of horses, such as the commissions and fees related to those sales. Appellant correctly excluded from her gross farm expenses those expenses attributable to her personal activities.

In each of the relevant tax years, appellant's gross farm expenses exceeded her gross farm income, resulting in a net farm loss. On appellant's returns these losses were used to offset United States-source income and foreign capital gains included in taxable income. On the theory that section 911 did not apply to service-capital business that operated at a loss, appellant did not exclude her foreign (section 911) earned income from her gross income with the attendant disallowance of expense deductions.

Upon audit, the Commissioner determined that 30% of appellant's gross farm income was compensation for her personal services on the farm, and therefore should have been excluded from her gross income as income

earned abroad within the meaning of section 911. Likewise, the Commissioner determined that 30% of appellant's gross farm expenses was allocable to and chargeable against this excluded earned income, and therefore should not have been deducted. These determinations reduced by 30% appellant's net farm loss in all but one of the tax years in question.[3] Based on this reduction in offsetting losses, the Commissioner calculated a deficiency in appellant's tax payments totalling in excess of $188,000. The Tax Court upheld the Commissioner. *Brewster v. Commissioner of Internal Revenue*, 67 T.C. 362 (1976). This appeal followed.

II

Appellant's first and principal contention is that section 911 has no application to a service-capital business that is operated at a loss. This is appellant's second visit to this court in quest of a holding to that effect. In the first proceeding, *Brewster v. Commissioner of Internal Revenue*, 473 F.2d 160 (D.C. Cir. 1972) (*"Brewster I"*), *aff'g per curiam*, 55 T.C. 251 (1970), appellant raised precisely the same question and offered basically the same analysis that she poses here. In *Brewster I*, which involved earlier years, the Commissioner and appellant had stipulated that appellant's capital and personal services were material income-producing factors in her business. Subsection (b) of section 911 limits excludable earned income from service-capital businesses to a reasonable allowance that is not to exceed 30% of the net profits from such a business. Appellant asserted that this provision—in particular, the 30% limit on earned

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[3] For the year 1963, 30% of appellant's gross farm income exceeded the then applicable dollar limitation of $35,000 for the earned income exclusion. *See* 26 U.S.C. § 911(b) (1958 ed. Supp. IV). In consequence, the disallowance of gross farm expenses for that year was also proportionately reduced.

income—displayed a congressional intent to confine application of section 911 to service-capital businesses that operate at a profit. She reasoned that excluding earned income derived from a business that operated at a loss would frustrate section 911's goal of benefiting taxpayers who live and work abroad. The Commissioner responded that Congress designed subsection (b) as an administrative convenience to alleviate the difficulties inherent in computing the appropriate allowance for personal services in a business in which both capital and services materially contributed to the production of income. He maintained that it had no relevance to a situation in which the losses from a service-capital business exceeded income.

We agreed with the Commissioner. Emphasizing the language of the statute, we wrote that "[t]he apparent anomaly of 'earned income' from a business operated at a loss is ascribable to the fact that the statutory concept of 'earned income' in § 911 is structured in terms of gross income rather than net profits." *Id.* at 162. We pointed out that the preface of section 911 does not mention profits or losses, but instead provides that "[t]he following items [*i.e.*, earned income] shall not be included in *gross income*," 26 U.S.C. § 911(a) (1976) (emphasis added). Although aware that the exclusions and limitations in section 911 engendered "certain incongruities" in particular circumstances, we observed that the Commissioner's reading of the statute does not transgress its basic rationale, which we described as an effort "to permit American business men [*sic*] to compete abroad with foreign entrepreneurs, without being subject to double taxation possibilities." 473 F.2d at 163. We also noted that in the vast majority of situations section 911 does indeed benefit the taxpayer living and working in a foreign country. In effect, avoiding appellant's misguided mingling of the concepts of "earned" and "taxable" income, we found no statutory barrier to a determination that a taxpayer could earn income from personal services

despite the fact that the income derived from a business that lost money.

Our holding in *Brewster I* disposes of appellant's first contention because the important principle of *stare decisis* requires that result. *Stare decisis* compels adherence to a prior factually indistinguishable decision of a controlling court. *E.g.*, *Braniff Airways, Inc. v. Civil Aeronautics Board*, 581 F.2d 846, 848-49 (D.C. Cir. 1978); *see* 1B *Moore's Federal Practice* ¶ 0.402[1] (2d ed. J. Moore & T. Currier 1974). This principle assumes increased importance when the antecedent case involves construction of a statute. *See* 1B *Moore's Federal Practice*, *supra* ¶ 0.402[5]. In its intra-circuit application, *stare decisis* demands that we abide by a recent decision of one panel of this court unless the panel has withdrawn the opinion or the court *en banc* has overruled it. *See*, *e.g.*, *United States v. Caldwell*, 543 F.2d 1333, 1339 & n.19 (D.C. Cir. 1974), *cert. denied*, 423 U.S. 1087 (1976); *United States v. Bryant*, 471 F.2d 1040, 1046 (D.C. Cir. 1972) (per curiam), *cert. denied*, 409 U.S. 1112 (1973). This principle encourages uniformity in the application of legal standards, enhances predictability in decisionmaking, promotes the interests of judicial efficiency and economy, and evinces respect for the efforts of earlier courts that have struggled to educe the appropriate legal norms.

Since our opinion in *Brewster I* no justifying legal changes have arisen to require a different result in this case. We do not reach this conclusion by any rigid or mechanical application of the principle of *stare decisis*. Since 1973, the date of that decision, Congress has made no changes in the text of section 911 that are relevant to this discussion. Nor has this court or the Supreme Court issued any decision that in any way erodes the force of *Brewster I*. Appellant offers no cogent basis favoring departure from our earlier disposition. The only subsequent decision to which she refers, *Vogt v.*

United States, 537 F.2d 405 (Ct. Cl. 1976), involved an entirely different issue from the one presented in *Brewster I* and the Court of Claims explicitly and carefully distinguished our decision, *see id.* at 415.[4] Thus, even were a contrary Court of Claims decision sufficient to relieve us of our obligation to follow a recent and well-considered decision of this court, we would find *Vogt* of only marginal value in a *de novo* analysis of this case.

Appellant insists that *Brewster I* is factually distinguishable from the instant proceeding because there the parties stipulated to the reasonableness of the amounts the Commissioner excluded from earned income and disallowed as deductions whereas here appellant contests those amounts. This argument misconceives the scope of the narrow issue decided in *Brewster I*. The sole question before that court was whether section 911 covered a service-capital business that operated at a loss. The only facts germane to that issue were that appellant's personal services and capital had been material income-producing factors in her business and that her business indeed operated at a loss. Those facts are no more disputed here than they were. We acknowledged that bizarre results might accompany application of section 911 in certain circumstances, but we did not condition our holding that section 911 applies to service-capital businesses that operate at a loss on the reasonableness of the Commissioner's determinations on excludable earned income from year to year and from taxpayer to taxpayer. The

[4] *Vogt* involved the question whether the Commission could apply the maximum dollar amount on excluded earned income to the taxpayer's share of the partnership's gross income. The Court of Claims, carefully noting that the question pertained only to the partnership setting, held that the Commissioner could not, and that instead the limit had to be applied to the taxpayer's share of the partnership's net income. 537 F.2d at 415. The court's rationale rested upon considerations peculiar to the tax status of partnerships. *See id.* at 410-15.

question of reasonableness is a separate inquiry, one in which *Brewster I* did not engage. Accordingly, on the issue of section 911 coverage, *Brewster I* controls this case.[5]

II

Anticipating our adherence to *Brewster I*, appellant alternatively complains that the Commissioner's determinations of the income she "earned" and of the expenses attributable to it are inconsistent with the statute and otherwise arbitrary and capricious. Courts play a restricted role in cases of this kind. Although our interpretation of the appropriate legal standards is bridled only by the deference due the Commissioner in certain circumstances, *see Commissioner of Internal Revenue v. Stidger*, 386 U.S. 287, 296 (1967); *Nico v. Commissioner of Internal Revnue*, 565 F.2d 1234, 1237 (2d Cir. 1977), our review of the Commissioner's and the Tax Court's application of the appropriate standards to a particular set of facts is considerably more restrained. A presumption of correctness accompanies a determination by the Commissioner. *Rockwell v. Commissioner of Internal Revenue*, 512 F.2d 882, 885 (9th Cir.), *cert. denied*, 423 U.S. 1015 (1975); *Plisco v. United States*, 306 F.2d 784, 786 n.2 (D.C. Cir. 1962). This places the burden of proceeding on the taxpayer, *see* 9 J. Mertens, *The Law of Federal Income Taxation* § 50.61 (J. Doheny ed. 1977), and thereafter the burden of persuasion rests with the taxpayer. *Helvering v. Taylor*, 293 U.S. 507, 515 (1935). That is, the taxpayer must show by a preponderance of

[5] Owing to our view that the principle of *stare decisis* controls, we need not consider whether *Brewster I* also collaterally estops appellant from relitigating the issue of section 911 coverage. The rules of collateral estoppel apply to tax proceedings exclusively involving issues of law, *see* Commissioner of Internal Revenue v. Sunnen, 333 U.S. 591, 598-599 (1948), but they are to be sparingly used, *see id.* at 600; 1B Moore's Federal Practice ¶ 0.442[3] (2d ed. 1974).

the evidence that the Commissioner's determination is in error. *See Burnet v. Niagra Brewing Co.*, 282 U.S. 648, 654 (1931); *Valley Title Co. v. Commissioner of Internal Revenue*, 559 F.2d 1139, 1141 (9th Cir. 1977); J. Mertens, *supra* § 50.62. If the Tax Court resolves facts in favor of the Commissioner or holds that the taxpayer has failed to meet that burden, then we must uphold the Tax Court unless its findings are clearly erroneous. *Farcasanu v. Commissioner of Internal Revenue*, 436 F.2d 146, 149 (D.C. Cir. 1970) (per curiam).

A

Section 911 provides that the Commissioner shall consider as earned income "a reasonable allowance as compensation for the personal services rendered by the taxpayer." 26 U.S.C. § 911(b) (1976). As we noted above, the Commissioner here found that 30% of appellant's gross farm income, which did not include gains from the sale of horses, constituted compensation for appellant's personal services on her farm. The Tax Court held that, while the Commissioner could not mechanically apply the 30% figure in every case, the appellant had failed to show that this assessment was unreasonable as applied to her. Appellant challenges this holding on two grounds. First, she argues, the Tax Court used the wrong test to determine whether she had in fact met her burden. She maintains that the Tax Court should have resorted to section 162(a)(1) of the Code for guidance in computing compensation under section 911. Second, she contends that no matter how the Commissioner computes earned income, he must include the gains she derived from the sale of horses in the base gross income figure. She maintains that these gains were an integral part of her farm income.

Section 162(a)(1) of the Code allows taxpayers to deduct as an ordinary and necessary business expense "a reasonable allowance for salaries or other compensation for personal services actually rendered." 26 U.S.C. § 162(a)(1) (1976). Noting the similarity between this language and that in section 911, appellant by way of analogy offered at trial evidence of the sums she would have had to pay replacement employees to perform the services appellant herself performed. These sums, appellant argues, are the proper measure of the compensation for the services she actually rendered in generating gross farm income. Appellant asserts that the Commissioner's alternative computation is an arbitrary figure, intimating that the Commissioner borrowed the figure from subsection (b)'s limitation on the amount of net profits a taxpayer can exclude as compensation from gross income.

We endorse the Tax Court's view that the statute neither requires nor permits the Commissioner, as a matter of administrative convenience or otherwise, to transform the reasonableness standard into a fixed 30% figure. The theory of *Brewster I* forecloses use of subsection (b)'s limitation to accomplish that result. The language of section 911 requires a case-by-case assessment of the income from a service-capital business that is reasonably attributable to the taxpayer's personal services. At the same time, however, we share the Tax Court's skepticism about the pertinence of a section 162 inquiry in the context of section 911. When a court confronts two different sections of the Code, each serving a different purpose and each having its own legislative background, it must hesitate in the absence of a clear congressional mandate before importing the incidents of one into the other. *Grunebaum v. Commissioner of Internal Revenue*, 420 F.2d 332, 335 (2d Cir.), *cert. denied*, 397 U.S. 1075 (1970). The considerations appropriate to a determination of reasonableness under section 162 are many and variegated, *see* 4A J. Mertens, *supra* § 25.69, and not all of those factors are helpful in a situation in which the

Commissioner must impute reasonable compensation where no compensation has actually been paid. No doubt some of the elements of a section 162 inquiry are useful in computing a reasonable allowance under section 911, but the latter provision may impose a more complex burden on the taxpayer to show that portion of the taxpayer's gross receipts that ought to be attributed to personal services rather than to capital.

Appellant's evidence on how much she would have had to pay replacement employees does not directly address the crucial question of the contribution *appellant's* services made to the production of gross farm income. She offered no evidence on the value of her services apart from the testimony on how long and hard she worked. Appellant was the proprietor and active manager of a business that operated at a loss, yet the cost-of-replacement evidence appellant offered does not reflect her status as proprietor or the fact that her business lost money. It belies common sense to assert that the services of an employee are fully comparable to the owner of a business who finances and manages the enterprise in addition to performing tasks employees would normally carry out. Using the compensation that would have been paid to replacement employees makes no allowance for the degree of the business' profitability or lack of profitability, a factor that is always relevant to consideration of the reasonableness of the compensation. It also assumes that appellant would have been willing to hire such replacement employees despite the existence of continual losses in her business. Moreover, as the Tax Court noted, appellant's evidence does not permit consideration of the work now done by appellant's employees that would have been done by replacements and which lessened the extent of the work demanded of appellant. In light of these factors, we cannot say that the Tax Court clearly erred in upholding the Commissioner's determination.

Similarly, we are unpersuaded by appellant's claim that her gross farm income must include receipts she

realized from the sale of horses for the purpose of computing the earned income exclusion. Appellant's task below was to show that the amount the Commissioner excluded as compensation was unreasonable. In determining whether appellant had met her burden, the Tax Court properly focused on the excluded amount rather than the base from which it was computed. As we have said, there is nothing magical about the 30% figure the Commissioner used. The Commissioner might have used a different figure, and it might have varied from year to year. The only requirement is that the resulting excluded earned income be reasonable. Hence there is no guarantee that the inclusion of horse sale receipts in the gross farm income would have materially affected the amount of excluded earned income. Moreover, appellant stipulated that she was in the business of breeding, training, and racing horses; her occasional sale of horses was incidental to that concern. Accordingly, on her tax returns, appellant excluded from her gross farm income the proceeds she received from the sale of horses and separately reported those proceeds to obtain favorable capital gains treatment. Styling those proceeds as part of her gross farm income for section 911 purposes would at least raise doubts about her entitlement to capital gains treatment under section 1231 of the Code. *See* 26 U.S.C. 1231 (1976).

B

Section 911 provides that the taxpayer shall not be allowed as a deduction from gross income any deductions "properly allocable to or chargeable against amounts excluded from earned income." 26 U.S.C. § 911(a) (1976). As we noted above, the Commissioner found that 30% of appellant's gross farm expenses, which did not include expenses directly associated with the sale of horses, were allocable to or chargeable against appellant's earned income. The Tax Court, while again correctly warning that the 30% figure could not be mechanically applied, held

that the Commissioner had acted lawfully. Appellant challenges this holding on four grounds. First she argues that only those expenses that replacement employees would have incurred should be subject to disallowance. This contention is no more persuasive on the expense side than it was on the income side, and thus we find it unnecessary to discuss it further.[6] Second she maintains that the statutory phrase "allocable to or chargeable against" requires that only those expenses be disallowed which are specifically identified with earned income. Third she insists that the amount of disallowed deductions cannot in any event exceed the amount of excluded earned income. Finally she contends that her gross farm expenses, the base from which the Commissioner determined the 30% figure, should have been reduced by excluding a portion of her ordinary farm expenses that could be attributed to her sale of horses.

Appellant's suggested item-by-item approach to section 911's disallowance provision hinges in part on her assertion that disallowed expenses must be specifically service-related rather than capital-related and in part on her contention that the words "allocable to" exhibit a congressional intent to confine disallowed expenses to those with a definite factual relationship to earned income. It may be that in some service-capital businesses the expenses related to capital and those related to personal services can be neatly cleaved in two. In appellant's business, however, it was an alliance of capital and personal serv-

[6] Appellant claimed in the Tax Court that because replacement employees would have incurred none of the expenses claimed by the appellant as the proprietor of a service-capital business, the excluded income should not be charged with any expenses. As the Tax Court noted, this approach, which would exclude income without a necessary disallowance of expenses, could produce a tax loss in excess of actual loss unless the replacement employee expenses were at least as great as the excluded earned income.

ices that combined to produce gross income. The purpose of section 911's disallowance provision is to ensure that the income excluded as "earned" remain burdened with the costs associated with its production. Section 911 identifies the disallowed expenses with the "amounts excluded from gross income" rather than with the rendition of personal services *per se*. This parallels the statute's language on the income side, which avoids conditioning a determination of earned income upon a finding that a particular item of gross income is identified with services rendered. A persistent failure to incur any one of the farm expenses we listed above would result in a gradual dimunition of appellant's gross receipts. There exists, then, a direct relationship between these expenses and the income appellant "earned." This relationship is all that the statute requires. It follows that we are unconvinced by appellant's attempt to circumvent the symmetry in section 911 by attaching controlling significance to the words "allocable to." Appellant's claim that Congress would have used the word "apportioned" had it contemplated use of a comparable ratio on the income and deduction sides has no support in either the language of the statute or its legislative history, and could lead to a situation in which a taxpayer's tax loss could exceed his actual loss.[7]

Appellant's contention that the amount of disallowed deductions can never exceed the amount of excluded earned income similarly lacks a foundation in either the

[7] *Cf.* n.6 *supra*. The Tax Court's example is useful:

> Assume total gross income of $1,000, expenses of $1,500, of which only $100 are clearly identified with earned income. On the basis of a 30-percent exclusion from gross income, the taxpayer would report $700 of gross income and, under [appellant's] theory, would be entitled to deduct $1,400. This produces a tax loss of $700, although the actual loss is only $500.

67 T.C. at 364 n.17.

language or the history of section 911. As the Tax Court pointed out, appellant's suggestion would also render our decision in *Brewster I* an academic exercise, for if the taxpayer reduced both the income and deduction sides by the same amount, the result would produce the same net loss as if section 911 had never been applied. That is why the *Brewster I* court, in dicta, expressly rejected this position. *See* 473 F.2d at 164 n.6. We refuse to do *sub rosa* what we earlier declined to do explicitly, *see* Part II *supra*, and accordingly we hold that section 911 does not forbid the disallowance of deductions in excess of the amount of income excluded as compensation from gross income.

Finally appellant poses the reflected image of her contention that receipts from her sale of horses ought to be included in her gross farm income for section 911 purposes. Appellant maintains that a portion of her gross farm expenses are properly allocable to the proceeds she received from selling horses, and therefore, if those proceeds are not to be included in the gross farm income figure, that such expenses should be excluded from her gross farm expenses for the purpose of computing the disallowance. The Tax Court correctly rejected this contention. The gross farm expenses appellant incurred reflect the ordinary costs of maintaining a farm for the breeding, training, and racing of horses. Appellant did not hold her horses for sale in the ordinary course of business and hence none of her ordinary expenses can be attributed to horse sales. In invoking the advantages of capital gains tax treatment on her sale of horses, appellant offset a portion of her horse sale proceeds with the expenses directly associated with those sales. *See* Part I *supra*. The statute does not entitle appellant further to offset her capital gain income by increasing in this manner the amount of the expenses she may deduct.

IV

Brewster I binds this court to a holding that section 911 applies to service-capital businesses operating at a loss. Appellant has failed to show that the Commissioner misconstrued that provision or that the Tax Court clearly erred in upholding the Commissioner's determinations thereunder. Accordingly, the decision of the Tax Court is

Affirmed.

APPENDIX B

APPENDIX B

ANNE MOEN BULLITT BIDDLE BREWSTER, PETITIONER *v* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 7063-71. Filed November 30, 1976.

Petitioner, a U.S. citizen residing abroad, operated a farming business as a sole proprietorship in Ireland at a loss. Petitioner's personal services as well as capital were material income-producing factors in the business. *Held*, under sec. 911(b), petitioner was required to exclude a portion of her gross farm income as "earned income." *Brewster v. Commissioner*, 473 F.2d 160 (D.C. Cir. 1972), affg. per curiam 55 T.C. 251 (1970); *Jack E. Golsen*, 54 T.C. 742 (1970), affd. on the substantive issue 445 F.2d 985 (10th Cir. 1971). *Held, further*, respondent's determination that 30 percent of gross farm income was a reasonable allowance as compensation for petitioner's personal services and, therefore, the amount of excludable earned income, sustained. *Held, further*, respondent's determination that 30 percent of petitioner's farm expenses were allocable to or chargeable against excludable earned income and nondeductible under sec. 911(a) sustained.

Thomas E. Jenks, *Herbert L. Awe*, and *Michael Mulroney*, for the petitioner.
Jon T. Flask, for the respondent.

Tannenwald, *Judge:* Respondent determined the following deficiencies in petitioner's Federal income tax:

Year	*Deficiency*	*Year*	*Deficiency*
1962	$25,071.98	1967	$24,505.82
1963	17,945.48	1968	16,435.89
1964	32,787.48	1969	68,912.27
1965	2,498.02		

The questions before us are: (1) Whether a portion of petitioner's gross farm income was excludable as earned income under section 911[1] when her foreign farming proprietorship operated at a loss, (2) if a portion was so excludable, the amount thereof, and (3) the amount of petitioner's farming expenses "allocable to or chargeable against" the excludable income.

FINDINGS OF FACT

Some of the facts have been stipulated and, together with the stipulated exhibits, are incorporated herein by this reference.

Petitioner was a citizen of the United States and a bona fide resident at Palmerstown Stud, in Kill, County Kildare, Ireland, at the time of filing her petition herein and during all of the years at issue. She filed timely individual Federal income tax returns for the years 1962 through 1969 with the Director, Office of International Operations, Internal Revenue Service, Washington, D.C.

At all times material herein, petitioner was engaged in the farming business in Ireland as an individual proprietor. Both petitioner's personal services

[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during each of the years before the Court.

and capital were material income-producing factors in the business.

Petitioner acquired her farm, Palmerstown Stud, in 1956 after an extensive search. The premises are favorably situated on limestone land which is considered to be desirable for raising horses. The farm encompasses 700 acres. In 1962, petitioner owned approximately 120 horses at Palmerstown. By 1969, that number had increased to about 200, most of which were brood mares and immature stock with approximately 25 to 30 racing horses in training. During the years in question, petitioner employed 45 or 50 individuals at all times.

Petitioner operated both a horse breeding farm and a training and racing stable at Palmerstown. In addition, each year petitioner grazed about 250 head of cattle which were useful for keeping the horse pastures in good condition and for controlling parasites.

Originally, petitioner intended only to carry on thoroughbred horse breeding; however, because of dissatisfaction with the results produced by public trainers, she began to train horses at Palmerstown. Petitioner believed that the combination of breeding and racing operations, which had developed fully at Palmerstown by the beginning of the period in question, would produce a greater degree of knowledge about an individual horse's capacity, stamina, and temperament. Consequently, she believed that coordinated development would aid in both training and selection for breeding. With the exception of several smaller operations, a combined breeding farm and racing stable such as Palmerstown is unique in Ireland. During the years in question, Palmerstown was

one of the largest thoroughbred horse operations in Ireland and horses bred and trained by petitioner won a number of internationally recognized races in Ireland, England, and France.

Petitioner was general manager and directed the breeding and racing operations herself during the years in question. She employed a stud groom who functioned as a foreman in charge of the breeding operation. Likewise, a head lad was employed and he functioned as a foreman in charge of the racing operation. During brief absences from Palmerstown by petitioner, the stud groom and head lad were left in charge of the breeding and racing functions. Petitioner performed all of the secretarial work. She employed an accountant to maintain Palmerstown's books and records. He also supervised planting, cattle grazing, and farm equipment operations. Petitioner supervised and directed the sale of the horses at Palmerstown.

For the years 1962 through 1969, petitioner realized the following income and expenses from the farming operation:[2]

Year	*Gross farm income*	*Gross farm expenses*	*Net farm loss*
1962.....	$83,155	$224,868	[3]$141,713
1963.....	123,502	235,717	112,215

[2] The figures as to gross farm income and gross farm expenses include adjustments to the amounts of these items as shown in the deficiency notice to take into account the effect of petitioner's horse racing activities, adjustments based upon the stipulation of the parties. In addition, gross farm income is exclusive of gain realized from the sale of horses. See pp. 365-367, *infra*. The amount of such gain is stipulated as follows: 1962, $84,951; 1963, $67,712: 1964, $159,770; 1965, $25,657; 1966, $30,411; 1967, $138,265; 1968, $68,400; 1969, $209,760.

[3] The parties stipulated this figure to be $141,173 in an obvious typographical error.

1964.....	38,238	234,241	196,003
1965.....	55,647	273,408	217,761
1966.....	64,070	290,674	226,604
1967.....	58,947	299,391	240,444
1968.....	48,809	262,685	213,876
1969.....	57,840	288,391	230,551

On her Federal tax returns for each of these years, petitioner reported all of her gross farm income and deducted all of her farming expenses. Her gain from the sale of horses was reported separately as long-term capital gain. Thus, she offset her U.S. source income with 100 percent of the losses she sustained from her foreign business.

The respondent determined that 30 percent of petitioner's gross farm income was excludable from gross income under section 911 as earned income. He further determined that the portion of gross farm expenses allocable to the excludable income, and therefore nondeductible, was the same percentage of gross expenses that excludable income was of gross farm income. The net effect of respondent's determination (modified in accordance with n. 2 *supra*) is the reduction of petitioner's net farm loss for each year, except 1963, by 30 percent.[4]

[4]

Year	*30% of gross farm income excluded*	*30% of farm expenses disallowed*	*Reduction in farm loss*
1962.....	$24,947	$67,460	$42,514
1963.....	*35,000	*66,801	31,801
1964.....	11,471	70,272	58,801
1965.....	16,694	82,022	65,328
1966.....	19,221	87,202	67,981
1967.....	17,684	89,817	72,133
1968.....	14,643	78,806	64,163
1969.....	17,352	86,517	69,165

*For this year, 30 percent of gross income exceeds the then-effective dollar limitation ($35,000) for the earned income exclusion. Sec. 911(c)(1)(B). The disallowance of farm expenses is accordingly proportionately reduced. See p. 365, *infra*.

Petitioner's farming expenses for the years in question were as follows: wages, social insurance for employees, feed for horses, grass seed for pastures, general supplies, repairs, fertilizers, stud fees and boarding expenses of brood mares at other stud farms, veterinary and medicine expenses, machinery operating expenses, insurance, bank interest and charges, electricity, telephone, rent, local taxes, carriage and freight for transporting horses, motor car expenses, horseshoeing, cost of training horses at other farms, straw, peatmoss, management fees, saddlery, periodicals, stationery, postage, gratuities to employees, travel and entertainment, subscription and entry fees for the registration of horses in stud book, tools and short life equipment, advertising, cattle buyers' commissions and fees, legal expenses, rental of special machinery, and entrance and jockey fees for horse races.[5] No part of these expenses claimed by petitioner was attributable to her personal expenditures.

OPINION

Section 911[6] affords a tax benefit to citizens who are residents of a foreign country to the extent that they realize income abroad as a result of their per-

[5] Petitioner also took deductions for depreciation in respect of property used in the business, but a portion of these deductions was attributed to the horses sold and reflected in the capital gain reported in respect of such sales.

[6] Sec. 911 provides in part:

SEC. 911. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES.

sonal services (earned income) rather than as a return on capital investments. In the case of a service-capital business, the statute provides that "a reasonable allowance as compensation for the personal services

(a) GENERAL RULE.—The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) BONA FIDE RESIDENT OF FOREIGN COUNTRY.—In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, *amounts received* from sources without the United States (except amounts paid by the United States or any agency thereof) *which constitute earned income attributable to services performed* during such uninterrupted period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

* * *

An individual shall not be allowed, as a deduction from his gross income, any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this subsection.

(b) DEFINITION OF EARNED INCOME.—For purposes of this section, the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer *engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary or his delegate, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.*

(Emphasis added.)

rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income."

On a prior occasion, this same taxpayer asked us to decide the identical question initially before us herein, namely, whether, under section 911, a citizen residing outside of the United States can have excludable "earned income" from a farming proprietorship in which both capital and personal services are material income-producing factors (service-capital business) when such proprietorship operates at a loss. In a Court-reviewed opinion, we answered that question affirmatively. *Anne Moen Bullitt Brewster*, 55 T.C. 251 (1970), affd. 473 F.2d 160 (D.C. Cir. 1972). We reasoned that the 30-percent limitation on the amount of net profits deemed to be earned income only applies to a business realizing net profits, since the limitation is expressed in terms of a percentage of net profits. Based upon this approach and because the benefit conferred takes the statutory form of an exclusion from gross income, we held that the excludable compensation factor was to be determined with reference to gross income. 55 T.C. at 254. Our decision was affirmed by the Court of Appeals for the District of Columbia in a per curiam opinion (473 F.2d 160 (D.C. Cir. 1972)), which rather extensively analyzed the issue involved and the views expressed by this Court.

Petitioner herein renews her contention that a proprietor of a foreign service-capital business generating losses cannot have any earned income within the meaning of section 911(b) and urges us to reexamine and abandon our position to the contrary. Respondent counters with the assertion that the rule established

in *Jack E. Golsen*, 54 T.C. 742 (1970), affd. on the substantive issue 445 F.2d 985 (10th Cir. 1971), requires us to follow our prior decision in view of its affirmance by the Court of Appeals for the District of Columbia, to which an appeal from a decision herein would lie.

It is clear that a decision herein for respondent on this threshold issue is required under *Golsen*. Such being the case, we reject petitioner's renewed contention.[7]

We turn to the questions as to how the amounts of excludable gross income and related expenses should be calculated—questions which did not have to be dealt with in the previous case because such amounts were stipulated by the parties.

Petitioner contends that if she had realized "earned income" from her farming operations, it was not determinable as a flat percentage of gross income. Rather, she maintains that the proper measure of her earned income is the amount she would have had to pay employees as reasonable compensation to perform all of the services she performed.

In making her argument, petitioner suggests that if we apply the prior decision in *Anne Moen Bullitt Brewster*, *supra*, then the 30-percent figure in the net profits limitation contained in the second sentence of

[7] We are cognizant of the intervening decision of the Court of Claims in *Vogt v. United States*, 537 F.2d 405 (Ct. Cl. 1976). But the issue in *Vogt* was an entirely different one, i.e., whether the dollar limitation of sec. 911 should be applied to a partner's share of the gross income or net income of a profitable personal service partnership, and the Court of Claims carefully distinguished *Brewster v. Commissioner*, 473 F.2d 160 (D.C. Cir. 1972), affg. 55 T.C. 251 (1970).

section 911(b) should not be imposed in determining what portion of gross income constitutes "a reasonable allowance as compensation for the personal services rendered" as provided in the preceding portion of that sentence. To the extent that petitioner's argument is based upon the assertion that the 30-percent argument is based upon the assertion that the 30-percent figure should not be mechanically applied, we agree with her position. Given the theory of the decision in *Anne Moen Bullitt Brewster, supra,* we think that the amount of reasonable compensation can, depending upon the facts and circumstances of each case, be found to be above or below 30 percent of gross income.[8] From this point on, however, petitioner's approach misses the mark.

In the first place, we are not convinced, as petitioner urges, that we should adopt precisely the same test for determining reasonable compensation under section 911(b) as is utilized in the cases involving the allowance of a deduction for compensation paid or accrued under section 162(a)(1), although we recognize that the two sections use substantially the same language.[9] There are numerous factors which enter into the determination of reasonableness under section 162(a)(1). See, e.g., *Pepsi-Cola Bottling Co. of Salina, Inc.*, 61 T.C. 564, 567-568 (1974), affd. 528 F.2d

[8] Indeed, even if a 30-percent limitation applied under the gross income theory, it is clear from the second sentence of sec. 911(b) that it only provides a ceiling and would not preclude a finding of less than 30 percent. That situation does not exist herein because neither party is contending for a lesser amount.

[9] Sec. 162(a)(1) allows a deduction, as an ordinary and necessary business expense, of "a reasonable allowance for salaries or other compensation for personal services actually rendered."

176 (10th Cir. 1975); 4A Mertens, Law of Federal Income Taxation secs. 25.69-25.81 (Malone rev.). Some of these factors are not present in a situation, such as is involved herein, where there is no compensation actually paid or accrued; rather the determination herein requires the construction of an *imputed* "reasonable compensation" geared directly to the portion of petitioner's gross receipts attributable to her services as opposed to her capital input. As we view the situation, only a combination of capital and personal services permits any receipts and this necessitates an inquiry as to the portion of the receipts which should be deemed attributable to each of such elements. Cf. *Mark Tobey*, 60 T.C. 227 (1973).

Thus, while it cannot be gainsaid that there are similarities in the decisional process under section 162(a)(1) and section 911(b), the latter situation has a somewhat different cast and the difficulties are perhaps even greater than those confronted in the former situation where, as has been observed, there is "no definite formula" (see *Jones Bros. Bakery, Inc. v. United States*, 411 F.2d 1282, 1291 (Ct. Cl. 1969)) or "universal rule" (see *Charles McCandless Tile Service v. United States*, 422 F.2d 1336, 1338 (Ct. Cl. 1970)). Compare *D. & N. Auto Parts Co.*, 8 T.C. 1192, 1196-1197 (1947).

In the second place, even if we were to agree that section 911(b) completely tracks section 162(a)(1), we would be unable to accept petitioner's argument herein. The bulk of that argument is based upon the contention that "the proper measure of petitioner's compensation is the amount she would have had to pay someone to replace her." Concededly, this is one of the elements to be taken into account but it cannot be

the sole element. If the latter were the case, the degree of profitability of the business (or, more accurately, the existence of continual losses) would be eliminated from our consideration, a clearly unacceptable consequence (see *The Barto Co.*, 21 B.T.A. 1197, 1199 (1931))—and one which also assumes that petitioner would be willing to expend the additional sums to compensate such replacement personnel notwithstanding the already large losses being incurred by the business (see *Crescent Bed Co.*, a Memorandum Opinion of this Court dated April 6, 1942, affd. 133 F.2d 424 (5th Cir. 1943)). Moreover, we would be unable to consider the degree to which petitioner's employees, such as the stud groom, the head lad, and the accountant (who discharged operational responsibilities), in fact performed services which would otherwise have been performed by the claimed replacement personnel and which lessened the extent of the activity demanded of petitioner. Finally, the standard suggested by petitioner would preclude consideration of the fact that petitioner's role was of a dual nature, consisting of contributions to the business not only in terms of the performance of services in a quasi-employee role but also in terms of her role as owner, i.e., using her resources to generate a return on her investment. Cf. *Charles McCandless Tile Service v. United States*, *supra* at 1338.

The ultimate question is what was the worth of petitioner's services in the generation of gross income of the business.[10] Although there is testimony as to how long and hard petitioner worked, we have been

[10] At the time the earned income credit was enacted by the Congress, the test as applied to a service-capital business was articulated as one "to determine what the man's own personal services are worth." See 65 Cong. Rec. 2850 (1924).

furnished with no evidence as to the value thereof, aside from the amount which purportedly would have had to be paid for replacement personnel. Such being the case, we are compelled to conclude that petitioner has failed to carry her burden of proof in overcoming respondent's determination that 30 percent of gross farm income constitutes "a reasonable allowance as compensation for the personal services rendered" within the meaning of section 911(b). In so concluding, we again emphasize that we are not adopting a mechanical formula for all cases. See pp. 358-359, *supra*. We are merely holding that, under the circumstances of this case, respondent's determination should not be overturned. In the foregoing context, any attempt by petitioner to upset respondent's determination on the ground that a flat percentage allowance will produce varying amounts of reasonable compensation from year to year falls by the wayside.

Petitioner further contends that, in computing the amount of her excludable earned income, the dollar limitations contained in section 911(c)(1), applicable to taxable years 1963 through 1965, should be increased in accordance with section 911(c)(7)[11] by the amount

[11] That paragraph provides:

(7) CERTAIN NONCASH REMUNERATION.—If an individual who qualifies under subsection (a)(1) receives compensation from sources without the United States (except from the United States or any agency thereof) in the form of the right to use property or facilities, the limitation under paragraph (1) applicable with respect to such individual—

(A) for a taxable year ending in 1963, shall be increased by an amount equal to the amount of such compensation so received during such taxable year;

(B) for a taxable year ending in 1964, shall be increased by an amount equal to two-thirds of such compensation so received during such taxable year; and

representing the value of the facilities of the business which she used. Under our holding, the dollar limitations applies only to the taxable year 1963. See p. 355, *supra*. Petitioner's argument is without merit. Although petitioner utilized the facilities of the business for personal purposes, e.g., the house and the automobiles, we know of no theory pursuant to which the value of such use or the deduction of the portion of the expenses allocable thereto could enter into the calculation of petitioner's taxable income from her sole proprietorship.[12] Even if some such theory could be constructed, it could not be said that such allocable portion of expenses was received as "compensation * * * in the form of the right to use." Sec. 911(c)(7). Compare *Challenge Manufacturing Co.*, 37 T.C. 650, 663 (1962) (disallowed expenses paid on behalf of a shareholder-employee not treated as compensation because not paid as such), and *Rapid Electric Co.*, 61 T.C. 232, 241 (1973) (to the same effect). Indeed, given this statutory language, there is a serious question whether it has any applicability with respect to the excludable gross income of sole proprietors.

We now turn to the deduction side of the section 911 computations. The governing provision is contained in section 911(a) and reads as follows:

> An individual shall not be allowed, as a deduction from his gross income, any deductions (other than those allowed by section 151, relating to

(C) for a taxable year ending in 1965, shall be increased by an amount equal to one-third of such compensation so received during such taxable year.

[12] In point of fact, petitioner herself allocated a portion of such expenses attributable to those facilities as personal and excluded them from the deductions claimed on her return.

> personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this subsection.

Petitioner first asserts that, since earned income should be determined by equating reasonable compensation with the amount she would have paid others to perform her services, nondeductible expenses allocable to earned income should only be those that such hypothetical other employees would have incurred. Since, according to petitioner, they would have incurred none of the expenses claimed by petitioner as a proprietor of a service-capital business, the excluded income should not be charged with any such expenses. Our rejection of the "employee approach" in respect of income disposes of this argument. The invalidity of petitioner's position is further revealed by the fact that such an approach, an exclusion from income without any disallowance of expenses, would produce a tax loss in excess of petitioner's actual loss.[13]

Petitioner next focuses on the statutory language disallowing deductions "allocable to or chargeable against" excludable income and argues that such language requires an item-by-item analysis of each farm expense to determine which expenses are definitely related to, or identified with, earned income. In this vein, petitioner takes the position that only four types of her farm expenses bore the requisite factual relationship to her personal services. Of these four expenses (motor car expense, motor car depreciation, travel and entertainment, and periodicals), petitioner

[13] This result would not obtain where it was possible to conclude that there were hypothetical employee expenses in an amount at least as great as the amount of excluded gross income.

claims only one-third of the costs was attributable to her personal services and the balance was attributable to her employees.

While it is true that a good portion of petitioner's total farming expenses appears to be capital-related (e.g., feed, seed, saddlery, repairs, etc.), the nature of this service-capital business is such that even these expenses are related to earned income since without them earned income could not have been realized. See *George Rousku*, 56 T.C. 548, 552 (1971); *Fred J. Sperapani*, 42 T.C. 308, 334 (1964).[14] Moreover, disallowed deductions are statutorily keyed to "amounts excludable from gross income," not to the personal services rendered per se, so that the standard urged by petitioner has no statutory foundation. In fact, petitioner's argument seeks to impart a definite identification of expenses with personal services on the deduction side, although as petitioner herself recognizes, the assignment of a portion of receipts to personal services on the income side is not based upon any definite identification of a particular item of gross income with the rendition of personal services.[15]

Petitioner attempts to attach some special significance to the words used by Congress in disallowing

[14] See also *Frieda Hempel*, a Memorandum Opinion of this Court dated June 23, 1947, in which all expenses of a business where capital was not a material income-producing factor were chargeable against earned income, although some of the expenses were of the type petitioner herein would allocate solely to capital (e.g., office supplies, managerial and secretarial expenses, etc.).

[15] We do not accept petitioner's suggestion that the comment of the Court of Appeals for the District of Columbia in the prior *Brewster* case (see 473 F.2d at 164 n. 6) requires an item-by-item analysis. That comment was made in the context of a stipulation in which the parties agreed as to which expenses were deductible and which were not, a situation which does not obtain herein.

expenses "allocable to or chargeable against" excluded income in section 911(a). She argues that these words require the disallowance of only those expenses as to which there is a definite factual relationship to her services, with all other expenses to be allowed as deductions, and that, had Congress intended to disallow expenses in the same ratio that excluded income bears to gross foreign-source income, as respondent has done, it would have instead chosen the word "apportionment." We see no reason to conclude that Congress intended that the standard to be applied on the deduction side of section 911 should operate in such a beneficial fashion for the taxpayer. Indeed, if petitioner's interpretation is correct, it can be argued that she has read the word "allocate" out of the statute, since the existence of a definite factual relationship would seem to be encompassed within the phrase "chargeable against." Cf. *Carstairs v. United States*, 75 F.Supp. 683, 685 (E.D. Pa. 1936).

Nor are we disposed to engage in a semantic exercise so as to divine shadings of legislative intention based on the use of the word "allocation" rather than "apportionment." It is of some significance that the dictionary defines "allocation" in terms of "apportionment." See Webster's Third New International Dictionary (Unabridged) (1965). Whatever may be the interpretation of these words in other sections of the Code,[16] we are not persuaded that we should adopt a narrow interpretation of the phrase "allocable to or chargeable against" used in section 911. Cf. *Carstairs*

[16] E.g., secs. 861 and 862 and the regulations thereunder, which were dealt with on a basis seemingly favorable to the taxpayer in *F. W. Woolworth Co.*, 54 T.C. 1233, 1269 et seq. (1970), although we are constrained to note that respondent had the burden of proof. See 54 T.C. at 1264.

v. United States, supra. In this connection, we note that, as in the case of petitioner's first argument relating to her deductions (see p. 362, *supra*), her "allocation vs. apportionment" theory could produce entitlement of a taxpayer to a loss in excess of the actual loss.[17]

We see no reason to construe a provision of the Code excluding amounts from gross income in a fashion so favorable to the taxpayer when the language of the provision does not compel this result. Perhaps there will be situations where the deductible items can be sufficiently identified as solely capital-related so as to justify the conclusion that they should not be disallowed under section 911(a). But such is not the case herein and consequently we sustain respondent's use of an allocation of 30 percent of expenses (except with respect to 1963, see p. 355 and n. 4, *supra*) to petitioner's excludable earned income. Here again we are constrained to note, as we did on the income side, that we are not putting our stamp of approval on the unvarying use of a percentage figure, much less a uniform 30 percent, on the deduction side, although we recognize that, in the usual situation, the use of the same percentage on the income and deduction sides is likely to be appropriate.

Perhaps because petitioner recognizes that her first two theories could produce situations where the deductible loss for tax purposes would exceed the

[17] Assume total gross income of $1,000, expenses of $1,500, of which only $100 are clearly identified with earned income. On the basis of a 30-percent exclusion from gross income, the taxpayer would report $700 of gross income and, under petitioner's theory, would be entitled to deduct $1,400. This produces a tax loss of $700, although the actual loss is only $500.

actual loss, she makes a still further argument that in no event should the amount of the disallowed deductions exceed the amount of excluded earned income. The basis for petitioner's contention is that such an approach is all that is necessary to avoid the double tax benefit against which the deduction provision in section 911 was presumably directed. Clearly there is no language in the statutory provision which provides any basis whatsoever for importing the suggested limitation. Moreover, the arithmetic of petitioner's proposal is such that it eliminates the same dollar amount on the income side and deduction side, thereby producing the same loss as is produced by using the gross figures on both sides. Obviously, adoption of such a proposal would render entirely nugatory the prior decision in *Anne Moen Bullitt Brewster, supra.* It is no doubt for this reason that the Court of Appeals specifically rejected this position, although such rejection can arguably be characterized as dictum. See 473 F.2d at 164 n.6.[18]

Respondent determined that the amount of gross farm expenses to be disallowed is—

$$\frac{\text{Excluded earned income}}{\text{Gross farm income}} \times \text{Gross farm expenses}$$

Petitioner argues that even if this formula is correct, the amount of gross farm expenses to be plugged in should not include an amount attributable to gain

[18] Moreover, the allowance of excess deductions (which is the other side of the same coin) was specifically rejected in *Frieda Hempel* (n. 14 *supra*). Compare also the discussion in *Ivor Cornman*, 63 T.C. 653, 660 (1975), with respect to the failure to obtain legislative sanction of this position in connection with excess deductions related to tax-exempt income under sec. 265.

from the sale of horses.[19] Petitioner reasons that because such gain, subject to beneficial capital gain treatment under section 1231, was not included in the gross farm income for purposes of computing earned income, no part of the expenses attributable to the horses sold should be disallowed as being allocable to the excluded earned income. Because petitioner cannot identify the expenses relating to the horses sold, which she would insulate from the proportional disallowance, she seeks to accomplish her objective by arguing that the amount of section 1231 gain realized each year should be added to the amount of gross farm income used by respondent in the denominator of the fraction previously noted.

The fact that the amount of such gain was not treated as part of gross income for purposes of computing excludable earned income is of no relevance in light of our rejection of the mechanical application of any percentage of gross income in arriving at such computation and our conclusion that petitioner has

[19] Petitioner also argues that the gross expenses should be reduced by expenses attributable to horserace winnings. It would appear that this argument is addressed to an error in respondent's deficiency notice calculations which netted gross race winnings and expenses. Respondent has conceded his error in this regard and the necessary corrections are reflected in the figures shown in our findings of fact. See pp. 354-355, *supra*. It would appear that this disposes of petitioner's contention in respect of this item.

Although this adjustment results in the disallowance of more expenses than were disallowed in the notice of deficiency, it also results in the exclusion of more income. Thus, but for the operation of the dollar limitation on earned income in 1963, respondent's adjustment, like his deficiency notice, results in the same amount of reduction of petitioner's claimed losses. For 1963, the reduction in petitioner's allowable loss is less than that in the deficiency notice.

failed to carry her burden of proof that the *amount* excluded did not represent "reasonable allowance as compensation for [petitioner's] personal services."

As for petitioner's contention that a certain portion of her gross farm expenses should be immune from the operation of the disallowance because a portion of such expenses was attributable to horses sold, we disagree. On her tax returns, petitioner offset the gain from such sales with expenses clearly identifiable therewith (e.g., commissions). Other expenses relating to such horses were basically breeding, racing, or maintenance costs and the fact of the matter is that petitioner maintained many, if not all, of the horses sold for breeding and racing, activities generating ordinary gross farm income through the combination of capital input and petitioner's personal services. Compare *Mark Tobey, supra; George Rousku, supra.* Thus, we find no basis for adjusting respondent's formula (either by directly reducing the gross farm expense element or by increasing the gross farm income denominator, with a consequent reduction in the amount of expenses disallowed) to reflect the fact that some of petitioner's ordinary farm expenses related to horses eventually sold.

It cannot be gainsaid that the legislative and judicial situation relating to the treatment of earned income abroad is far from satisfactory. It has, as the Court of Appeals for the District of Columbia has observed in its opinion in the prior *Brewster* case, produced "certain incongruities" and a condition which "is not welcomed." See 473 F.2d at 163-164. Any remedy of such "incongruities" and "unwelcome condition" must, in our opinion, emanate from the Congress.

Reviewed by the Court.

Decision will be entered under Rule 155.

Sterrett and Quealy, *JJ.*, did not participate in the consideration and disposition of this case.

Hall, *J.* concurring: I agree with Judge Goffe on the merits but think *Golsen* requires a decision for respondent.

Goeffe, *J.*, dissenting: I respectfully dissent. The majority opinion is cast in terms of exclusions from gross income but the end result is to deny the full losses petitioner sustained in the operation of her farm. This result is produced by holding that *Jack E. Golsen*, 54 T.C. 742 (1970), affd. 445 F.2d 985 (10th Cir. 1971), precludes examination of our prior decision and requires a decision in favor of respondent.

Our holding in *Jack E. Golsen, supra*, recognized that if a party losing a case in the Tax Court appealed to a Court of Appeals which previously held a position contrary to ours, that he would win on appeal. Therefore, in the interest of efficient and harmonious judicial administration we held that in such instances we would apply the holding of that Court of Appeals. We stated that "We shall remain able to foster uniformity by giving effect to our own views in cases appealable to courts whose views have not yet been expressed, and, even where the relevant Court of Appeals has already made its views known, by explaining why we agree or disagree with the precedent that we feel constrained to follow." 54 T.C. at 757. *Golsen* involved a position of the Court of Appeals that arose from an appeal from the District Court not the Tax Court. *Golsen* requires us to follow the position of the Court of Appeals for the circuit in which the taxpayer

resided at the time he filed his petition in the Tax Court. All appeals from cases initiated in the Tax Court by United States citizens residing abroad lie in the United States Court of Appeals for the District of Columbia. If the *Golsen* rule is applied to the instant case, therefore, a whole class of taxpayers (U.S. citizens residing abroad), are precluded from having us reexamine our holding in the first *Brewster* case unless such taxpayers pay the tax and sue in the Court of Claims or unless they change their residence to the United States, except to the District of Columbia. The *Golsen* rule is solely a rule of law of the Tax Court. It is not etched in stone. It has been neither commended nor criticized by a Court of Appeals or the Supreme Court. It has never been extended to apply to the same taxpayer. Application of the *Golsen* rule in this case makes our prior opinion virtually "review-proof." I conclude, therefore, that *Golsen* should not compel a decision for respondent but we should, instead, freely examine our holding in the first *Brewster* case. Moreover, the recent holding of the Court of Claims in *Vogt v. United States*, 537 F.2d 405 (Ct. Cl. 1976), severely undermines the rationale of our prior *Brewster* decision and that of the Court of Appeals in the first *Brewster* case.

The majority in the instant case disallows 30 percent of petitioner's deductions from the operations of her farm in Ireland under section 911(a) of the Code. This section is not a general section of the Code. It provides only for disallowance of deductions *properly allocable to or chargeable against amounts excluded from gross income*. The sole purpose of disallowing deductions so "allocable or chargeable" is to prevent a double benefit; i.e., excluding the income and deducting the expenses relating to such income. There is no

statutory prohibition against offsetting foreign deductions against income from U.S. sources. Even the majority permits petitioner to offset the remaining 70 percent of her Ireland farm deductions against income from U.S. sources.

The disallowance of petitioner's deductions comes about by *requiring* petitioner to exclude 30 percent of the *gross* income from operations of her farm in Ireland. On her returns petitioner excluded no income from the operation of the farm because it operated at a loss. In the first *Brewster* case we held that she *must* exclude 30 percent of the *gross* profits from the farm although section 911(b) *allows* an exclusion not to exceed 30 percent of *net* profits. The exclusion is designed to permit a U.S. citizen residing abroad to exclude from income a portion of the net income from a trade or business attributable to the personal services rendered by such a taxpayer as distinguished from the portion of net income produced by invested capital. We held in the first *Brewster* case that the 30-percent limitation on the amount of income excludable was applicable only if there were net profits from the business; because there were only losses, not profits, the limitation did not come into play; and, therefore, petitioner must exclude 30 percent of *gross* profit. Accordingly, under section 911(a), we required that a portion of petitioner's deductions be disallowed (the amount to be disallowed was stipulated in the first *Brewster* case but not in the instant case).

The exclusion provided in section 911(a) is for "earned income" as that term is defined in section 911(b). The definition of earned income which is embodied in section 911(b) originated in the Revenue Act of 1924. It had nothing to do with income earned from

foreign sources but, instead, was defined in order to impose a lower rate of tax on all earned income. Sec. 209(a)(1), Revenue Act of 1924, ch. 234, 43 Stat. 263, 264. The limitation was enacted to facilitate administration of the Act. H. Rept. No. 179, 68th Cong., 1st Sess. (1924), 1939-1 C.B. (Part 2) 241, 245. S. Rept. No. 398, 68th Cong., 1st Sess. (1924), 1939-1 C.B. (Part 2) 266, 281; 65 Cong. Rec. 2850. The concept of earned income as distinguished from income derived from invested capital in the case of unincorporated businesses resulted from a floor amendment to the bill designed to aid farmers (as is petitioner here) and small businessmen. 65 Cong. Rec. 2849. The application of the "earned income" concept to exclude income earned outside the U.S. was first enacted in the Revenue Act of 1926. Sec. 213(b)(14), Revenue Act of 1926, ch. 27, 44 Stat. 26. At that time Congress also provided that deductions properly allocable to or chargeable against such excluded income were not allowable (now sec. 911(a)). Although Congress has changed the percentage and has otherwise modified the percentage limitation on exclusion of earned income it has never expressed the limitation in terms other than as a percentage of *net profits*. The effect of our prior decision, the decision of the Court of Appeals, and now, the majority, is to nullify the language of the percentage limitation when the business suffers a *net loss*. Such an interpretation is erroneous. There is no legislative history to support our prior conclusion. Moreover, it is fundamental in statutory construction to give effect to all of the language of the statute. *Hellmich v. Hellman*, 276 U.S. 233 (1928); *Larkin v. United States*, 78 F.2d 951 (8th Cir. 1935); *Stanford v. Commissioner*, 297 F.2d 298, 308 (9th Cir. 1961); *William C. Stolk*, 40 T.C. 345 (1963), affd. per curiam 326 F.2d 760 (2d Cir. 1964).

The limitation of 30 percent of net profits should be applied in all cases, regardless of the existence of net profits. Therefore, applying the limitation literally, to a net loss as we have here, 30 percent of zero is zero and the limitation of section 911(b) precludes exclusion of any portion of petitioner's income as "earned income." Because no income is excluded, no deductions are disallowed under section 911(a). Moreover, our interpretation in the first *Brewster* case is not consonant with the taxation of proprietorships generally; i.e., no income is realized by virtue of the efforts of the proprietor unless a net profit results.

In the first *Brewster* case the Court of Appeals held that the statutory concept of "earned income" was structured in terms of gross income not net profits. *Brewster v. Commissioner*, 473 F.2d 160, 162 (D.C. Cir. 1972). That conclusion has since been rejected by the Court of Claims. *Vogt v. United States*, 537 F.2d 405 (Ct. Cl. 1976). That case involved the method of computing the amount excludable from income under section 911(a) received from a partnership which operated outside the U.S. It did not involve an allocation between the income attributable to the taxpayer's personal services and the income attributable to the invested capital but, instead, whether the dollar limitation on the amount excludable applied to the partner's distributive share of the gross profit of the partnership or its net profit. Relying in part on our decision in *Warren R. Miller, Sr.*, 51 T.C. 755 (1969), the Court exhaustively examined all of the interpretations of section 911 and concluded that the taxpayer demonstrated that there was a long-standing administrative interpretation that a partner's "earned income" from a pertnership is his share of *net* profits. The *net* profits concept, so aptly explored by the Court of Claims, in

the partnership context should apply here to a sole proprietorship. In both cases a taxpayer includes in his gross income his *net* profit from a proprietorship or his distributive share of the profits of a partnership (except for items upon which the Code imposes limitations). By the same token, he deducts the *net* loss of his sole proprietorship or his distributive share of the *net* loss of the partnership.

The *net* profits concept is the only rationale that is consistent with taxation generally. Requiring petitioner to exclude 30 percent of the *gross* profits of the proprietorship is not consistent with the general scheme of taxation of sole proprietorships or partnerships. Expression of the exclusion in terms of an exclusion from gross income in section 911(a) does not make the exclusion a gross income concept. It merely identifies the point in the computation of the taxpayer's overall tax liability at which the exclusion applies. All exclusion provisions are expressed in terms of exclusion from gross income.

The reliance by the Court of Claims on *Warren R. Miller, Sr., supra*, requires an examination of our holding in that case. We had before us the meaning of the term "earned income" for purposes of reduction of retirement income in connection with the retirement income credit. We were called upon to interpret that term as it is used in section 911(b), the identical section involved herein. We thoroughly analyzed the term and concluded that earned income was keyed to *net* profits, not *gross* profits. 51 T.C. at 762. In the first *Brewster* case we admitted that *Miller* "gave us pause"; however, we dismissed petitioner's contention that *Miller* applied by pointing out that in *Miller* we were coordinating two sections of the Code which we were

not doing in *Brewster*. That is a distinction without a difference. Section 37, which allowed the retirement income credit, incorporated by reference section 911(b). We may have so lightly dismissed our prior interpretation of section 911(b) in *Miller* when we decided the first *Brewster* case but the Court of Claims considered it viable enough to quote from our *Miller* opinion in its opinion.

I conclude that our interpretation of "earned income" in section 911(b) as being a *net* profits concept as fully developed in *Miller*, was correct as is the opinion of the Court of Claims in *Vogt*, relying on *Miller*, and we erred in holding to the contrary in the first *Brewster* case which, in turn, led the Court of Appeals in *Brewster* to an erroneous conclusion. I would, therefore, hold that the 30-percent limitation of section 911(b) means exactly what it clearly says without any "court made" limitation; "30 percent of his share of the *net* profits of such trade or business." Applying the unmistakable language of section 911(b) to the "net profits" of petitioner's trade or business; i.e., a net loss, 30 percent of zero is zero and petitioner had no earned income and no deductions should be disallowed under section 911(a).

Featherston, Irwin, and Wiles, *JJ.*, agree with this dissent.

APPENDIX C

APPENDIX C

(Filed June 28, 1979)

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 77-2010

ANNE MOEN BULLITT BIDDLE BREWSTER, Appellant

v.

COMMISSIONER OF INTERNAL REVENUE, Appellee

BEFORE: MacKinnon and Robb, Circuit Judges; and Richey*, Judge, United States District Court for the District of Columbia

ORDER

Upon consideration of appellant's petition for rehearing or remand, it is

ORDERED, by the Court, that appellant's aforesaid petition is denied.

Per Curiam

For the Court,

/s/ George A. Fisher
Clerk

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*Sitting by designation pursuant to Title 28 U.S.C. §292(a).

(Filed June 28, 1979)

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 77-2010

ANNE MOEN BULLITT BIDDLE BREWSTER, Appellant

v.

COMMISSIONER OF INTERNAL REVENUE, Appellee

BEFORE: Wright, Chief Judge; Bazelon, McGowan, Tamm, Leventhal, Robinson, MacKinnon, Robb, and Wilkey, Circuit Judges

ORDER

The suggestion for rehearing *en banc* filed by appellant Anne Moen Bullitt Biddle Brewster, having been transmitted to the full Court and no judge in regular active service having requested a vote with respect thereto, it is

ORDERED, by the Court, that appellant's aforesaid suggestion for rehearing *en banc* is denied.

Per Curiam

For the Court:

/s/George A. Fisher
Clerk

Circuit Judge Leventhal did not participate in the foregoing order.

APPENDIX D

APPENDIX D

Internal Revenue Code of 1954 (26 U.S.C.):*

SEC. 911. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES.

(a) [as amended by Sec. 11(a), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960] *General Rule*.—The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) *Bona fide resident of foreign country*.—In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such uninterrupted period.***

* * *

An individual shall not be allowed, as a deduction from his gross income, any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this subsection.

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* The provisions of section 911 set forth here are as they were during the 1962-1969 period in question.

(b) *Definition of Earned Income.*—For purposes of this section, the term 'earned income' means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary or his delegate, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

* * *